

**STATE OF CALIFORNIA  
DEPARTMENT OF INSURANCE  
45 Fremont Street, 21st Floor  
San Francisco, California 94105**

**NOTICE OF PROPOSED ACTION**

**DATE: August 13, 2004**

**REGULATION FILE: RH02024483**

**SUBJECT OF PROPOSED RULEMAKING**

The Insurance Commissioner proposes to amend the regulations described below after considering comments from the public. The Commissioner proposes revise California Code of Regulations, Title 10, Chapter 5, Subchapter 3, Article 17, §§ 2580.1 to 2580.9 (the "Actuarial Opinion and Memorandum Regulation"). With some exceptions, the amendments conform to revisions that have been made by the National Association of Insurance Commissioners (NAIC) to the text of NAIC Model regulation 822, upon which text the current Actuarial Opinion and Memorandum Regulation is based.

**AUTHORITY AND REFERENCE**

The proposed regulations will implement, interpret and make specific the provisions of Insurance Code section 10489.15. Insurance Code section 10489.15 also provides the authority for this rulemaking.

**PUBLIC HEARING**

The Commissioner will hold a public hearing to provide all interested persons an opportunity to present statements or arguments, either orally or in writing, with respect to this regulation, as follows:

**Date and time:           October 6, 2004, at 10:00 a.m.**

**Location:                Ronald Reagan State Building  
Hearing Room, First Floor  
300 South Spring Street  
Los Angeles, CA 90013**

The hearing will continue on the date noted above until all testimony has been submitted or 4:00 p.m., whichever is earlier.

## **PRESENTATION OF WRITTEN COMMENTS; CONTACT PERSONS**

All persons are invited to submit written comments on the proposed regulations during the public comment period. The public comment period will end at 5:00 p.m. on October 6, 2004. Please direct all written comments to the following contact person:

George Teekell, Staff Counsel  
California Department of Insurance  
45 Fremont Street, 21st Floor  
San Francisco, CA 94105  
Telephone: (415) 538-4390

Questions regarding procedure, comments, or the substance of the proposed action should be addressed to the above contact person. If he is unavailable, inquiries may be addressed to the following backup contact person:

Ahmad Kamil, Senior Life Actuary  
California Department of Insurance  
300 South Spring Street, South Tower  
Los Angeles, CA 90013  
Telephone: (213) 346-6147

## **DEADLINE FOR WRITTEN COMMENTS**

All written materials must be received by the Insurance Commissioner, addressed to one of the contact persons at his respective address listed above, no later than 5:00 p.m. on October 6, 2004. Any written materials received after that time will not be considered.

## **COMMENTS TRANSMITTED BY E-MAIL OR FACSIMILE**

The Commissioner will accept written comments transmitted by e-mail provided they are sent to the following e-mail address: teekellg@insurance.ca.gov. The Commissioner will also accept written comments transmitted by facsimile provided they are directed to the attention of George Teekell and sent to the following facsimile number: (415) 904-5490. **Comments sent to other e-mail addresses or other facsimile numbers will not be accepted. Comments sent by e-mail or facsimile are subject to the deadline set forth above for written comments.**

## **INFORMATIVE DIGEST**

### **Summary of Existing Law and Policy Statement Overview**

Each year life and disability insurers are required to prepare along with their annual statement an actuarial opinion and memorandum. In the actuarial opinion and memorandum an actuary opines, in a form prescribed by law, on the sufficiency of the insurer's reserves to cover anticipated claims.

Included in the current regulations is the requirement for the appointed actuary to opine on the adequacy of the assets held with respect to the reserves, including any investment earnings on the assets. This is commonly referred to as asset adequacy testing or asset adequacy analysis. When actuaries do this testing they create models, using different economic scenarios, to replicate the insurer's financial components (premiums, claims, expenses...) over a horizon of usually 20 or 30 years. The results of this testing are the projected profits or surpluses, illustrated year by year. Under the current regulations there are a minimum of seven prescribed interest rate scenarios, which are mandatory for the asset adequacy analysis. An actuary is free to use more scenarios depending on the type of products the insurer markets, in addition to the seven prescribed scenarios.

The existing regulations allow certain smaller insurance companies an exemption from doing full-fledged asset adequacy testing, provided they satisfy the eligibility tests listed in the regulations. In essence, the existing regulations establish a two-tiered system for actuarial opinions. The insurers that are not exempt (typically those whose admitted assets exceed \$500 million) are required to conduct sufficient tests such that they can certify that their assets make adequate provision for their liabilities, i.e., their appointed actuaries must perform a full-fledged asset adequacy analysis. Other insurers, satisfying certain conditions, e.g. satisfactory financial ratios, are exempt from this requirement, and need only certify that their reserves have been computed in accordance with the formulae specified in the regulations.

The reserves of an out-of-state foreign insurer, under the current regulations, must meet the requirements of the insurance law and regulations of the state of domicile, and must be at least as great as the minimum aggregate amounts required by the State of California.

By and large, the proposed regulations closely parallel recent revisions made by the NAIC to the model regulation upon which the California regulations being amended by this rulemaking were originally based. The current revisions to the NAIC model regulation are in the process of being adopted by several different states. It can be beneficial to both insurers and consumers when administrative costs related to compliance with multiple, inconsistent regulatory requirements imposed by different states are reduced. The proposed regulations tend to serve this purpose by ensuring that California's regulatory requirements in this area are as consistent with those of other states as is possible under California law. To the extent that insurers, operating in compliance with California law, are able to devote additional resources — resources which would otherwise be expended satisfying multiple, inconsistent regulatory regimes — to improving their financial stability or providing better products to consumers, everyone stands to benefit. The proposed regulations are reasonably necessary to the degree to which they help to achieve progress toward this goal.

### **Effect of Proposed Action**

One major change proposed in the revised regulations is the elimination of the mandatory seven interest rates scenarios. This gives the appointed actuary more discretion to use his or her professional judgment in performing the asset adequacy analysis and developing the actuarial opinion and supporting memoranda. However, the Commissioner will have the authority to

specify specific methods of actuarial analysis and actuarial assumptions when, in the Commissioner's judgment, these specifications are necessary.

Along with granting the appointed actuary greater discretion, the proposed regulations charge him or her with commensurately heightened responsibility. For example, the current regulations allow the actuary to rely on other experts to develop the analysis, and to state this in the opinion. However, the proposed regulations give the actuary the additional responsibility of reviewing for reasonableness and consistency the information or data relied upon, rather than merely accepting it at face value. Furthermore, the appointed actuary is required in certain cases to certify not only that she has reviewed the company's basic asset and liability records but also that she has reconciled them to them to the company's annual statement.

Another proposed change is to eliminate the exemption granted to certain smaller companies from doing an asset adequacy analysis in arriving at their actuarial opinions. The proposed change will not only bring all insurers onto a level playing field, but will also enable the appointed actuary to utilize his or her judgment in determining the extent of asset adequacy analysis that is necessary, taking into consideration the individual circumstances of the particular insurer.

The proposed revisions further include a requirement that a confidential summary of the assumptions and the results of the asset adequacy analysis be submitted to the Commissioner. It is anticipated that the addition of this summary will increase the efficiency with which the actuarial opinion and memorandum are reviewed, since the actuarial opinion and memorandum can often be a voluminous and complex document. The proposed regulations depart from the NAIC model regulation, however, in that they contain an additional requirement that insurers provide such additional information as the Commissioner may require.

## **MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS**

The proposed regulations do not impose any mandate on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with Section 17500) of Division 4 of the Government Code would require reimbursement.

## **COST OR SAVINGS TO STATE/LOCAL AGENCY OR SCHOOL DISTRICT OR IN FEDERAL FUNDING**

The Commissioner has determined that the proposed regulations will result in no cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code, no other nondiscretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State.

## **ECONOMIC IMPACT ON BUSINESSES AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE**

The Commissioner has made an initial determination that the proposed regulations may have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. As described above, certain previously exempt insurers will for the first time be required to perform asset adequacy analysis as part of the actuarial opinion and memorandum they must prepare each year. The types of businesses that may be affected are life insurers, reinsurers and fraternal benefit societies. The Commissioner has not considered proposed alternatives that would lessen any adverse economic impact on business and invites interested parties to submit proposals. Submissions may include the following considerations:

- (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to businesses.
- (ii) Consolidation or simplification of compliance and reporting requirements for businesses.
- (iii) The use of performance standards rather than prescriptive standards.
- (iv) Exemption or partial exemption from the regulatory requirements for businesses.

## **POTENTIAL COST IMPACT ON PRIVATE PERSONS OR ENTITIES/BUSINESSES**

The Commissioner has determined that for certain insurance companies that are exempt under the current regulations, and as such are not required to perform a full-fledged asset adequacy analysis, there is likely to be an additional cost impact. For companies that have never performed the asset adequacy analysis, this additional cost is estimated to be in the range of \$10,000 to \$30,000 per year. However, for many of these companies, the impact has already been mitigated by the following:

- The NAIC model regulation has already been adopted in a number of states, and the previously exempt companies doing business in those states are thereby required to perform the asset adequacy analysis, irrespective of whether or not the proposed regulations require it. Consequently, if California adopts regulations similar to the model, the additional work required of these companies is likely to be minimal.
- Since 2003 the model has been included in the NAIC Accounting Practices & Procedures (AP&P) Manual, which insurers licensed in California are required to follow per Insurance Code section 923. According to the AP&P Manual, SSAP No.1 Section 7, companies that employ practices different from AP&P must disclose the effect of these practices, so that companies who do not perform the full-fledged asset adequacy analysis as required under current California regulations must generate an estimate of the results of such an analysis. For this reason, the cost of generating such an estimate is already being borne by these insurers; the additional cost of actually performing the analysis will be lower for these companies than would be the case for a company not already generating the estimate.

- Certain of the smaller companies are currently required to perform the asset adequacy analysis every three years; the cost of complying with the proposed regulations for these companies as well will thus be significantly lower than if they had never before been required to perform the analysis.

## **FINDING OF NECESSITY**

The Commissioner finds that it is necessary for the welfare of the people of the state that the regulations apply to businesses.

## **EFFECT ON JOBS AND BUSINESSES IN CALIFORNIA**

The Commissioner is required to assess any impact the regulations may have on the creation or elimination of jobs in the State of California, the creation of new businesses, the elimination of new businesses, and the expansion of businesses currently operating in the state. The Commissioner estimates that the proposed regulations may help spur the creation of approximately ten jobs in the consulting and insurance industries in California. Interested parties are invited to comment on this issue.

## **IMPACT ON HOUSING COSTS**

The matters proposed herein will have no significant effect on housing costs.

## **ALTERNATIVES**

The Commissioner must determine that no reasonable alternative considered by the Commissioner or that has otherwise been identified and brought to the attention of the Commissioner would be more effective in carrying out the purposes for which the regulations are imposed or would be as effective and less burdensome to affected private persons than the proposed regulations. The Commissioner invites public comment on alternatives to the regulations.

## **IMPACT ON SMALL BUSINESS**

The Commissioner has determined that the proposed regulations will not affect small business. Pursuant to Government Code section 11342.610, subdivision (b), paragraph (2), insurers are not small businesses.

## **COMPARABLE FEDERAL LAW**

There are no existing federal regulations or statutes comparable to the proposed regulations.

## **TEXT OF REGULATIONS AND INITIAL STATEMENT OF REASONS**

The Department has prepared an initial statement of reasons that sets forth the reasons for the proposed regulations. Upon request, the initial statement of reasons will be made available for

inspection and copying. Requests for the initial statement of reasons or questions regarding this proceeding should be directed to the contact person listed above. Upon request, the final statement of reasons will be made available for inspection and copying once it has been prepared. Requests for the final statement of reasons should be directed to the contact person listed above.

The file for this proceeding, which includes a copy of the proposed regulations, the statement of reasons, the information upon which the proposed action is based, and any supplemental information, including any reports, documentation and other materials related to the proposed action that is contained in the rulemaking file, is available for inspection and copying at 45 Fremont Street, 21st Floor, San Francisco, California 94105, between the hours of 9:00 a.m. and 4:30 p.m., Monday through Friday.

### **AUTOMATIC MAILING**

A copy of this notice, including the informative digest, which contains the general substance of the proposed regulations, will automatically be sent to all persons on the Insurance Commissioner's mailing list.

### **WEBSITE POSTINGS**

Documents concerning this proceeding are available on the Department's website. To access them, go to <http://www.insurance.ca.gov>. Find near the end of the rightmost column, under the heading "Quick Links," the "Legal Information" link. Click it. On the "Legal Information" page, click on the "Proposed Regulations" link near the top of the page. When the "Search or Browse for Documents for Proposed Regulations" screen appears, you may choose to find the documents either by conducting a search or by browsing for them by name.

To search, enter "RH02024483" (the Department's regulation file number for these regulations) in the search field. Alternatively, search using as your search term the California Insurance Code section number of the code section that the regulations implement ("10489.15"), or search by keyword ("actuary," for example, or "reserves"). Then, click on the "Submit" button to display links to the various filing documents.

To browse, click on the "Browse All Regulations" button near the bottom of the screen. A list of the names of regulations for which documents are posted will appear. Find in the list the "Actuarial Opinion and Memorandum Regulation" link, and click it. Links to the documents associated with these regulations will then be displayed.

### **MODIFIED LANGUAGE**

If the regulations adopted by the Department differ from those which have originally been made available but are sufficiently related to the action proposed, they will be available to the public for at least 15 days prior to the date of adoption. Interested persons should request a copy of these regulations prior to adoption from the contact person listed above.